

June 2, 1998

D.T.E. 98-46

Petition of Western Massachusetts Electric Company requesting approval by the Department of Telecommunications and Energy for the issuance up to \$180 million in Intermediate Term Notes in connection with certain nuclear fuel financing arrangements.

APPEARANCES: Jane P. Seidl, Esq.
Western Massachusetts Electric Company
c/o Northeast Utilities Service Company
P.O. Box 270
Hartford, Connecticut 06141

-and-

Stephen Klionsky, Esq.
260 Franklin Street
Boston, Massachusetts 02110

FOR: WESTERN MASSACHUSETTS ELECTRIC
COMPANY
Petitioner

I. INTRODUCTION

In Western Massachusetts Electric Company, D.P.U. 873 (1981), the Department of Public Utilities, now the Department of Telecommunications and Energy ("Department"), approved the participation of Western Massachusetts Electric Company ("WMECo" or "Company") in the Niantic Bay Fuel Trust (the "Trust") which is intended to facilitate the financing requirements for the purchase of nuclear fuel for Millstone Units Nos. 1, 2 and 3. The Trust uses proceeds of credit financing arrangements, including issuances of a series of Intermediate Term Notes ("IT Notes") with an aggregate principal amount of \$300,000,000, to obtain nuclear fuel and leases the fuel to the participants, WMECo and Connecticut Light and Power Company ("CL&P"). Western Massachusetts Electric Company, D.P.U. 873, at 4-7 (1981).¹ In Western Massachusetts Electric Company, D.P.U. 91-129 (1991), the Department approved an amendment to the Trust that included, among other things, the creation of a revolving credit agreement ("Credit Agreement") with a syndicate of banks. Recently, the Department approved the Company's request to amend the Credit Agreement ("Amended Credit Agreement") which, among other things, allowed WMECo to extend the term of the Amended Credit Agreement to July 31, 1998. Western Massachusetts Electric Company, D.T.E. 97-108 (1998). In addition, the Department allowed WMECo to issue no less than \$17,100,000 in aggregate principal amount of First Mortgage Bonds, Series A, as additional collateral as required

¹ The Company stated that WMECo and CL&P own approximately 18.779 percent and 81.221 percent (for a total of 100 percent), respectively, of Millstone Unit Nos. 1 and 2 and are responsible for fuel costs for those units (Exh. WM-8, at 3). WMECo and CL&P own approximately 12.239 percent and 52.933 percent (for a total of 65.172 percent) respectively, of Millstone Unit No. 3, and are responsible for a like percentage of fuel costs of Millstone Unit No. 3 (id.).

by the Amended Credit Agreement approved in D.T.E. 97-108. Western Massachusetts Electric Company, D.T.E. 98-29 (1998).

On May 1, 1998, pursuant to G.L. 164, § 14, WMECo filed an application with the Department for the approval for the issuance by the Trust of \$180,000,000 of Series G IT Notes at an interest rate not to exceed 9.25 percent per annum, with maturities ranging from three to five years.² WMECo also requested that the Department approve certain modifications to its Series G IT Note Purchase Agreement ("Note Agreement") to alter certain prepayment provisions and terms and conditions of the issuance of these notes. The Company's petition was docketed as D.T.E. 98-46. Pursuant to notice duly issued, a hearing was held at the Department's offices in Boston on May 22, 1998. At the hearing, the Company sponsored the testimony of David R. McHale, assistant treasurer of finance of WMECo. The evidentiary record consists of eight Company exhibits,³ 59 Department exhibits, and two Company responses to Department record requests. There were no petitions for leave to intervene filed.

II. DESCRIPTION OF THE PROPOSED FINANCING

With respect to the issuance of notes, the Company requests the Department's approval of the issuance by the Trust, on or before June 4, 1998, of an aggregate principal amount of \$180 million in Series G IT Notes, which have been subscribed to at an interest rate of 8.59 percent and

² CL&P is also seeking approval of these matters in the State of Connecticut (Exh. WM-5, at 8). The interest rate and maturity periods provided in the petition were amended during the hearing, as discussed below.

³ On May 22, 1998, the Company submitted a final draft of the Note Agreement (Exh. WM-3). This document replaces the draft copy the Company submitted to the Department on May 7, 1998.

with a maturity of five years (Exhs. WM-3; DTE-20; Tr. at 9-15).⁴ The Company noted that Series G IT Notes will rank equally with any remaining obligations under the Amended Credit Agreement with respect to both payment priority and collateral (Exh. WM-8, at 5). The Company stated that it will issue these notes to institutional investors in the private placement market in order to provide flexibility to take advantage of the most cost-effective financing for the nuclear fuel for the Millstone units (id. at 6; Exhs. WM-1, at 7; DTE-9). The Company stated that its current financial condition is such that alternative financing arrangements, such as bank financing and the use of the Company's general working capital, are not satisfactory alternatives (Exh. WM-1, at 8).

The Company stated that the proceeds of the Series G IT Notes will be used to:

(1) refund \$80,000,000 aggregate principal amount of the Trust's Series F IT Notes, which will expire on June 5, 1998; (2) retire or reduce its \$90,000,000 obligation to provide additional collateral to the Trust pursuant to the Amended Credit Agreement;⁵ (3) cover approximately \$4,000,000 in issuance costs; and (4) place the remaining \$6,000,000 in the Trust's cash collateral account for future purchases of nuclear fuel (Exh. WM-8, at 9; Tr. at 17).⁶ The Company stated

⁴ WMECo's share of this issuance is \$33,802,200 (Exh. DTE-4; Tr. at 39-40). WMECo's share of expenses is \$676,044; its total share of legal and miscellaneous fees is \$74,178 (Exh. WM-4 at 3; Tr. at 39).

⁵ WMECo's portion of this additional collateral, \$17,100,000, was approved in D.T.E. 98-29 (1998).

⁶ The Company stated that the Series G IT Notes will be secured by: (1) the Lease under which the Company leases nuclear fuel owned by the Trust; (2) all nuclear fuel owned by the Trust; (3) all nuclear fuel contracts, assignments, and bills of sale with respect to the nuclear fuel; (4) other rights and assets described under the Security Agreement (Exhs. (continued...))

that the issuance of the Series G IT Notes will meet all the obligations of the Trust (Tr. at 14).

While WMECo has not decided on the future of the Amended Credit Agreement currently scheduled to expire on July 31, 1998, the Company stated that it may extend the existing Amended Credit Agreement at a much smaller amount or structure a new Credit Agreement (id. at 17).

With respect to the Note Agreement, the Company requests Department approval of modifications to certain portions of the Note Agreement that differ from the Series F IT Note Purchase Agreement (Exhs. WM-8, at 4; WM-3).⁷ These modifications include (1) retention of WMECo's 1998 Series A First Mortgage Bonds and CL&P's 1998 Series A First and Refunding Mortgage Bonds as collateral; (2) requiring the trustee to repurchase the collateral first mortgage bonds under certain conditions; (3) amending the mandatory redemptive prepayment provision to allow the noteholder to redeem the notes under certain conditions; and (4) reducing the IT Note debt limitations from \$300 million to \$200 million (Exhs. WM-8, at 4; DTE-20, at 1). The Company stated that these modifications were necessary to obtain broad investor support for a successful marketing of the private placement offering (Exh. DTE-20, at 1; Tr. at 11).

First, the Company stated that it had originally expected that the additional collateral of \$90,000,000 in First Mortgage Bonds, 1998 Series A, approved in D.T.E. 98-29, would be released when the Amended Credit Agreement expires on July 31, 1998 (Exh. DTE-26; Tr. at

⁶(...continued)
WM-5, at 15; WM-8, at 5).

⁷ WMECo is required to obtain Department approval of material amendments to the Trust's arrangements before they become effective. D.P.U. 873, at 15; D.P.U. 873-A, at 1.

11). However, WMECo noted that because potential Series G IT Notes investors had concerns regarding the economic uncertainties surrounding the Company, the Company modified the Note Agreement to require that the bonds remain as collateral until CL&P's credit ratings are returned to investment grade by either Moody's Investor Service or Standard & Poor's Corporation, or when the bonds mature on June 1, 1999 (Exhs. WM-3, at 20; DTE-7; Tr. at 12, 20-22). The Note Agreement also provides that if WMECo or CL&P fail to give notice that an extension or replacement of the collateral first mortgage bonds has been satisfied, each note holder has the right to require the trustee to repurchase these bonds in full (Exhs. WM-3, at 11-13; DTE-20, at 13).

Finally, the Company stated that a modification in the Note Agreement provides that, upon a partial termination of the lease, a holder of Series G IT Notes may require the Company to redeem, at par, a portion of IT Notes held by the Company (Exhs. WM-1, at 5, WM-3, at 11). This portion bears the same ratio to all outstanding IT Notes and bank debt as the stipulated loss value of the Nuclear Fuel released from the Lease bears to the stipulated loss value of all Nuclear Fuel then subject to the Lease (Exh. WM-3, at 11; Tr. at 15).

As noted above, the Department previously approved a credit limitation for issuing Intermediate Term Notes of \$300,000,000 in D.P.U. 873 and 873-A. The Company has requested approval of a modification to the Note Agreement to reduce the credit limitation to \$200,000,000 (Exhs. WM-3, at 17; DTE-20, at 1).

III. STANDARD OF REVIEW

In order for the Department to approve the issuance of stock, bonds, coupon notes, or other types of long-term indebtedness⁸ by an electric or gas company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.⁹ Colonial Gas Company, D.P.U. 84-96 (1984).

The Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its Section 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990).

⁸ Long-term refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

⁹ The net plant test is derived from G.L. c. 164, § 16.

The Fitchburg I and II and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed issuance "is not limited to a 'perfunctory review.'" Fitchburg I at 678; Fitchburg II at 842, citing Lowell Gas at 52. Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

Where issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

IV. CAPITAL STRUCTURE OF THE COMPANY

WMECo states that the net plant test does not apply to the proposed issuance of the Series G IT Notes (Exh. WM-1, at 12). The Company contends that for accounting purposes, its 18.779 percent share of the Series G IT Notes would be reported as obligations under Capital Leases, and accordingly, would not be included as debt for purposes of calculating the net plant test (id.). As of March 31, 1998, the Company's utility plant in service, including nuclear fuel

inventories, was \$1,316,390,000 (RR-DTE-2, at 1). The accumulated depreciation against this plant was \$574,314,000 (id.). As of March 31, 1998, the Company's total capitalization was \$639,363,200 (id. at 2). This consisted of total common stock and paid-in surplus of \$178,284,000, preferred stock of \$38,000,000, long-term debt of \$347,777,000,¹⁰ and \$41,500,000 in book long-term debt and preferred stock due to mature within the next twelve months (id.; Tr. at 39). In addition, WMECo has another \$17,300,000 in long-term debt recently approved in Western Massachusetts Electric Company, D.T.E. 98-29 (1998), and \$80,000,000 in Series A 1997 First Mortgage Bonds approved as security for the Revolving Credit Agreement in Western Massachusetts Electric Company, D.P.U. 97-33 (1997) (Exh. DTE-26).

Thus, as of March 31, 1998, the Company has net utility plant in service of \$742,076,000 (\$1,316,390,000 - \$574,314,000) and excess of net utility plant over outstanding capital of \$102,712,800 (\$742,076,000 - \$639,363,200) (RR-DTE-2, at 2). Inclusion of the \$80,000,000 in outstanding 1997 Series A First Mortgage Bonds approved in D.T.E. 97-33 and the \$17,300,000 in outstanding 1998 Series A First Mortgage bonds approved in D.T.E. 98-29 results in excess net utility plant of \$5,412,800 (\$102,712,800 - \$97,300,000).¹¹

V. ANALYSIS AND FINDINGS

¹⁰ \$33,802,200 represents WMECo's obligation towards the issuance of the \$180,000,000 in Series G IT Notes and was used in calculating total long-term debt (Tr. at 39).

¹¹ In D.T.E. 97-33, the Department had approved the issuance and authorization of up to \$90,000,000 in 1997 Series A First Mortgage Bonds. WMECo stated that although the order authorized the issuance of \$90,000,000, only \$80,000,000 is currently outstanding (Tr. at 29). The Company allocated the remaining \$10,000,000 towards financing the \$17,300,000 of 1998 Series A First Mortgage Bonds under the agreement with Niantic Bay Trust revolving credit facility approved in D.T.E. 98-29 (Exh. DTE-26; Tr. at 29-30).

WMECo seeks the Department's approval for (1) the issuance of \$180,000,000 of Series G IT Notes with an interest rate of 8.59 percent and a maturity of five years and (2) modifications to certain portions of the Note Agreement.

Based on the foregoing, the Department finds that the proposed issuance of \$180,000,000 of Series G IT Notes to be issued during the period from the date of this Order through June 5, 2003, and bearing an interest rate of 8.59 percent is reasonably necessary to accomplish a legitimate purpose in meeting the Company's service obligations in accordance with G.L. c. 164, § 14.

While the Company maintains that the net plant test is not applicable in this proceeding, a company asking the Department to approve an issue of new stock, bonds or other securities should be able to demonstrate that the proposed issuance meets the net plant test. Colonial Gas Company, D.P.U. 84-96, at 8 (1984); see also G.L. c. 164, § 16. Even without accepting the Company's position on the relationship of capital lease indebtedness to the net plant test -- i.e., that capital lease indebtedness need not be reckoned in the net plant test formula -- the proposed financing falls below the net plant ceiling. See D.P.U. 97-33 at 5-6 (Department silent on capital lease and net plant). Because it is not necessary to define this relationship in order to rule on the instant petition, we defer the question to a later case. The Department finds that WMECo's proposed issuance of Series G IT Notes meets the net plant test, since the Company's net plant would exceed its total capital stock and long-term debt by \$5,412,800 after the proposed issuance. Issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in this proceeding; therefore, the Department's decision does not represent a

determination that any specific project is economically beneficial to the company or to its customers. The Department's determination in this Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing.

With respect to the modifications to the Note Agreement, the Department finds that the proposed changes are necessary in order to allow WMECo to meet its nuclear fuel requirements, thus accomplishing a legitimate purpose in meeting the Company's service obligations in accordance with G.L. c. 164, § 14. Accordingly, the Department approves the modifications to the Note Agreement. The Department reminds the Company that WMECo must obtain prior Department approval of material amendments to the Trust before they become effective. D.P.U. 873, at 15. In addition, WMECo must file copies of all IT notes as well as purchase agreements within ten days prior to their execution. Id.

Finally, the Department notes its concern with any negative effect financings may have on a company's restructuring initiatives. The type and specific structure of a company's financing affects its obligation to its shareholders and bondholders as well as its credit rating. Such obligations and corporate financial health may dictate to some extent the corporate structure and thus may hinder the company from choosing a revised corporate structure such as the divestiture or even the functional separation of generation assets. WMECo stated that the approval of the proposed financing is not expected to affect the Company's current or future plans for recovering stranded costs or restructuring including its ability to divest its generating assets (Exhs. DTE-33; DTE-36).

V. ORDER

Accordingly, after due notice, hearing and consideration, the Department

VOTES: That the issuance by Western Massachusetts Electric Company of Series G Intermediate Term Notes at an interest rate of 8.59 percent, is reasonably necessary for the purpose for which such issues have been authorized; and it is

ORDERED: That the Department hereby approves and authorizes the issuance by Western Massachusetts Electric Company of Series G Intermediate Term Notes with a maturity date of June 4, 2003, in the aggregate principal amount of \$180,000,000, at an interest rate of 8.59 percent, no earlier than June 5, 1998; and it is

FURTHER ORDERED: That the Department hereby approves and authorizes the amendments to the Note Purchase Agreement dated May 20, 1998 by Western Massachusetts Electric Company; and it is

FURTHER ORDERED: That the First Mortgage Bonds approved in this Order shall be used for the purposes as set forth herein; and it is

FURTHER ORDERED : That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of the Commonwealth.

By Order of the Department,

Janet Gail Besser, Chair

James Connelly, Commissioner

W. Robert Keating, Commissioner

Paul B. Vasington, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).